Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

AT&T REPLY COMMENTS

AT&T Corp. respectfully submits this Reply to the Comments filed in response to the Commission's Report and Order and Second Further Notice of Proposed Rulemaking, FCC 04-31, released February 2, 2004, published in 69 Fed. Reg. 12814 (March 18, 2004) ("Second MAG Order" and "SFNPRM").

The commenting parties are in nearly unanimous agreement that the Commission should make available both the CenturyTel and the ALLTEL/Madison River/TDS ("ALLTEL") alternative regulation plans, but they disagree on a number of significant implementation issues.[1] AT&T urges that none of the Comments provides good reason

[1] Sprint opposes both plans, claiming the current price cap regime is sufficient, and urges that the plans, in any event, be delayed until the Commission completes its intercarrier compensation docket. While AT&T agrees that prompt completion of that docket is the preferable course, these two proposals are a useful interim step to provide at least some limitation on rate-of-return LECs' overearnings while the Commission works towards a

to depart from AT&T's proposal that the Commission (i) adopt and promptly implement a modified version of the CenturyTel plan, making it mandatory at the holding company level for all rate-of-return LECs serving more than 50,000 lines and, (ii) require those LECs (other than average schedule companies) with less than 50,000 lines at the holding company level to either elect the CenturyTel plan or operate under a modified version of the ALLTEL plan. The Comments also do not provide any good reason to depart from or abrogate altogether the "all-or-nothing" rule, which is a valuable safeguard against cost shifting.

i. Participation Should Be Mandatory

While most LEC industry groups favor participation in either plan only on a voluntary basis, sound policy reasons favor a requirement for mandatory participation in the CenturyTel plan by larger rate-of-return LECs and mandatory participation in the ALLTEL plan by smaller LECs who do not opt for the CenturyTel proposal. With respect to the larger LECs,[2] MCI (at 2-3) and AT&T (at 7-9, 14-17) have shown that the passage of Section 204(a)(3) of the Communications Act, has denied access users any effective remedy for recovery of past damages for overcharges, making it increasingly urgent to provide some alternative protection against LEC overearnings. Mandatory

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long-term, comprehensive solution. Both plans should be implemented promptly, by July 1, 2004, if possible, but in all events not later than October 1, 2004, as ALLTEL (at 5) proposes. AT&T does not object to ALLTEL's further proposal that tariffs filed under either plan prior to the normal July 1, 2005 date be allowed to remain in effect until July 1, 2007, the date on which the smaller LECs' next tariffs would take effect.

[2] AT&T has proposed a threshold of 50,000 lines, while MCI has suggested 100,000 lines. AT&T favors the lower threshold because the benefits to consumers will be greater with the broader application of the plan, but has no objection to a higher threshold. As AT&T shows in Attachment 1, the 50,000 line threshold will include 10 additional companies or study areas with approximately 694,000 lines, that account for about 4.7% of total lines provided by rate-of-return carriers.

participation in incentive regulation by these LECs should provide at least some incentive for more economically efficient pricing and a small measure of consumer protection, which is now lacking. The commenters urging voluntary participation offer no alternative means to stem the abuse that is prevalent because of consumers being denied the right to recover damages for past overearnings.

MCI (at 2-3) and AT&T (at 16-20 and, n.28) also showed that improper cost shifting and regulatory gaming by moving between incentive and rate-of-return schemes is a real concern that must be addressed in any incentive regulation plan. While the LECs, of course, deny that cost shifting has occurred or will occur, they offer nothing but their self-serving conclusory assertions and vague references to other regulatory safeguards to support their denials.[3] In fact, cost shifting is extremely difficult to detect — even if the Commission had the resources to try to do so — and it is far preferable to adopt a regulatory structure that discourages this practice at the outset rather than to try to detect it once it occurs. Local competition, whether from wireless or other wireline carriers, is not yet sufficiently wide-spread or effective to prevent this abuse. The assertion that mandatory participation will somehow be a disincentive to investment (USTA at 3) is also unsupported and baseless. Indeed, it is a stock claim that LECs have come to routinely assert in opposition to any regulations they believe may threaten their

[3] *See, e.g., USTA* at 2. AT&T's Comments (at 17-21) showed, that existing modes of regulation are simply not sufficient to prevent the myriad abuses that would persist in a voluntary scheme (and which are inhibited by the all-or-nothing rule), particularly given the size and complexity of today's LEC ownership structures and the limited resources available to the Commission for enforcement.

high returns by limiting their ability to raise prices.[4] The reason most LECs oppose mandatory participation is clear: it provides some measure of protection against regulatory abuses and therefore may limit the ability of LECs to realize overearnings which ratepayers cannot recover because Section 204(a)(3) of the Act precludes recovery of past damages. But that is the strongest possible reason for adopting a mandatory participation rule, not for rejecting it.

ii. The "All-or-Nothing" Rule Should Be Retained and Applied to PRTC

These same concerns as to cost shifting and regulatory gaming militate strongly in favor of retaining and enforcing the "all-or-nothing" rule, which the commenting LECs also generally oppose.[5] Like mandatory participation, "all-or-nothing" provides a structural safeguard against cost shifting and similar regulatory abuses that are essential to consumer protection. Such protection is not effectively provided by any of the alternative methods cited by the LECs. Conclusory assertions that, "LECs need the flexibility to operate all their affiliates under the form of regulation [they find] most efficient and least restrictive" (e.g., USTA at 3) merely highlight the continued need for the rule, because the form of regulation a LEC will select will assuredly be the one that is most profitable for the LEC and generate the highest rates for consumers, who have no

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[4] For example, in the ongoing TELRIC rulemaking proceeding USTA (and all of the commenting LECs) have made this same argument with respect to cost based unbundled network element rates. See Comments of USTA, filed December 16, 2003, *In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173.

[5] *See, e.g.*, USTA at 6; OPASTCO at 2-3; NTCA at 2.

meaningful remedy to recover overearnings.[6] The concerns over cost shifting that caused the Commission to adopt the all-or-nothing rule in the first place in the *LEC Price Cap Order*,[7] and the Court of Appeals to affirm the rule as a reasonable and necessary means to inhibit cost shifting,[8] are even more urgent today because the ability to unfairly shift costs poses a threat to competition that is finally emerging in the local exchange market. Rather than weakening or eliminating the rule altogether (as Verizon and USTA urge), the Commission should retain and vigorously enforce it.

Indeed, as MCI (at 6-7) points out, the conversion of Verizon's own subsidiary, Puerto Rico Telephone Company ("PRTC"), to price cap regulation is long overdue and should be ordered promptly.[9] In seeking outright elimination of this rule, Verizon however, claims that if PRTC converted to price cap regulation, PRTC would receive less support under the methodology for distributing Interstate Access Support ("IAS") funds

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[6] As AT&T's Comments (p. 20 and Appendix A-2 and A-3) showed, over the past eight years, incentive regulation has proven far more effective than rate-of-return regulation in reducing switched access rates. Rate-of-return regulation would be more "appropriate" only in those circumstances where cost savings under incentive regulation are insufficient to make continued operations profitable, and such circumstances occur infrequently, if at all. *Id.*

[7] See *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786 [¶ 272] (1990) ("LEC holding companies have both the means and the motive to shift costs improperly from affiliates under one regulatory system to affiliates under another system, to the detriment of ratepayers.")

[8] *See NRTA v. FCC*, 988 F.2d 174, 179 (D.C. Cir. 1993) (holding such rules "are central to price cap regulation").

[9] PRTC has repeatedly obtained waivers to allow it to remain under rate-of-return regulation despite the requirement of Section 61.41(c) that non-price cap carriers convert to price caps within one year of their acquisition by a price cap carrier. See, *In the Matter of Puerto Rico Telephone Company Petition for Waiver of Section 61.41(c) of the Commission's Rules or, in the Alternative, Request for Waiver of Section 54.303(a) of the Commission's Rules, Memorandum Opinion and Order*, 17 FCC Rcd. 27,694 (2002).

than it currently receives from the Interstate Common Line Support ("ICLS") fund. Verizon cites this as a reason for eliminating the "all-or-nothing" rule.[10]

Verizon's concerns are of no practical significance and do not warrant eliminating the rule. To accommodate situations like the PRTC acquisition, it would be reasonable to modify (or waive) the rules to make the total amount of IAS funding flexible, so that it could be adjusted upward to accommodate study areas moving from rate-of-return regulation to price cap regulation (i.e., CALLS) and adjusted downward in the event that any study areas moved from price caps to rate-of-return regulation. Such adjustments can and should be done in a manner that does not increase total USF funding. This could admittedly result in some rate-of-return study areas receiving less support when they convert to price caps, since the formula for distributing IAS funds is less generous than that for ICLS.

But, as noted, this provides no basis to eliminate the all-or-nothing rule. First, the price cap rules would permit PRTC to offset any decline in USF support by instituting a PICC charge, and if necessary, reinstating a CCL charge. Second, CALLS is scheduled to terminate in July 2005; thus the need to impose PICC or CCL charges would only be temporary.

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[10] Verizon (at 6-8) requests that the Commission clarify that the CALLS and IAS systems cannot accommodate new carriers or new study areas during the duration of CALLS. Verizon emphasizes that the existing IAS fund, which is capped at $650 million, does not contain any provision for accommodating additional carriers or study areas that may be added to CALLS and require support. Verizon (n.9) notes that the $650 million ceiling could be increased, based on the amount of ICLS the new carrier or study area was receiving before becoming part of CALLS. However, citing its own acquisition of PRTC as an example, Verizon claims this approach, could adversely affect rate-of-return carriers that were acquired by price cap carriers.

Should the Commission nevertheless conclude that LECs may adopt an alternative regulatory plan on a study area by study area basis, AT&T shares the Commission's concern (SFNPRM, ¶ 78) that LECs may potentially use an alternative regulatory plan to shift costs from study areas for which it has elected a plan, to study areas which continue to be regulated using the traditional cost model. The Commission's tentative conclusion (SFNPRM, ¶ 91), that the election by a holding company of an alternative plan in any study area can only be made if the holding company files its own cost-based tariffs in all of its non-average schedule study areas, is one possible way to ensure that cost shifting would be both more readily detectable and would insulate the NECA pools from possible cost shifts.[11] Additionally, a study area once placed under incentive regulation should not subsequently be permitted to retreat to an alternative traditional form of regulation. If a LEC could not escape its choice of incentive plans it would be much more difficult to permanently shift costs either between study areas or jurisdictions.

iii. Incentive Regulation Can Be Accommodated Within The NECA Pool

In addition to the potential for cost shifting within a holding company, the Commission is concerned that it might be more difficult to identify cost shifting if alternative regulatory plans are implemented within the NECA pools. AT&T believes that assuming all non-average schedule LECs within a holding company adopt incentive regulation, then with certain protections, an incentive plan could coexist within the

[11] AT&T also agrees with MCI (at 4), that in such event, there should be limits as to the type and number of lines that may be left under rate-of-return regulation to allow the Commission to more readily detect possible abuse of the plan, and that the Commission should adopt a specific date, perhaps three years, by which all rate-of-return study areas would have to convert to price cap regulation.

NECA pooling process.[12] As the Commission notes, NECA would need to develop rate of return and rate development procedures for each of the alternative plans elected by the participants in the pool. For example, if a pool participant were to request a lower formula adjustment, NECA should be required to provide all of the relevant data, calculations and documents that would support the need for the rate adjustment. In all events, it appears that incentive regulation may be accommodated within the NECA pool, but additional details should be provided by NECA.[13]

iv. An X-Factor and Sharing Should Be Adopted

MCI (at 4-6) points out that while the CenturyTel proposal does not specifically address the X-factor applicable to special access services, its apparent intent is to effectively freeze special access rates at current levels. MCI correctly observes that this would result in a substantial windfall for any rate-of-return carrier converting to price cap regulation, because with the steady growth in special access demand, there has been and should continue to be a decline in unit costs. AT&T agrees with MCI's proposal that as

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[12] NECA (at 4-5) claims that both the CenturyTel and ALLTEL plans could be accommodated within existing pool mechanisms. Under the CenturyTel plan (or other price cap scheme), access revenues would be distributed to pool members on a formula basis, rather than on a cost basis, similar to what is currently done for average schedule companies. The settlement formula would vary by pool, with common line revenues distributed on a per-line basis and traffic sensitive revenues distributed on a per-minute basis (either $0.0095 or $0.0125, depending on the carrier's line density) (NECA, fn.12).

[13] NECA has not provided further details on exactly how the system would work and AT&T urges that the Commission review NECA's detailed proposal if it is to consider allowing participation on a study area basis. Additional information is required, for example, on exactly how various price cap adjustments would be implemented in a pooled environment; whether separate pools should be established for price cap and rate-of-return LECs, and how pricing flexibility would work in a pooling environment.

these costs decline, they should be passed through to customers through application of an X-factor.[14]

AT&T also urges adoption of MCI's proposal (at 5) for a sharing mechanism, at least for an initial transition period, modeled on the plan adapted in the *LEC Price Cap Order*, to share 50% of any earnings between 12.25% and 16.25%, and 100% of any earnings above 16.25%.[15] As MCI suggests, any sharing amounts allocated to the common line, switching and transport baskets should first be used to reduce the amount of a carrier's draw from the ICLS fund. AT&T agrees there is a strong likelihood that rate-of-return carriers, who have been operating without efficiency incentives, should experience significant efficiency gains under incentive regulation. As the Commission recognized in the *LEC Price Cap Order*, ratepayers should "receive their fair share of productivity gains that occur."[16]

v. Participation in the ALLTEL Plan Should Be Mandatory and Two Safeguards Should be Added to the Plan

AT&T urges that smaller carriers who elect not to participate in the CenturyTel plan should be required to participate in the ALLTEL plan. Smaller rate-of-return carriers should be provided at least some incentive for cost cutting and more efficient

[14] MCI proposes an X-factor of 6.5%, which appears reasonable based on data available to AT&T. If the Commission believes additional data is required to determine the appropriate percentage, AT&T would support any reasonable adjustment.

[15] 5 FCC Rcd. at 6801 [¶ 124].

[16] *Id.* MCI (at 6, n.9) is also correct in observing that none of the factors which caused the Commission to eliminate sharing for current price cap carriers after many years of experience under price caps apply here, where the sharing carriers would be moving from their current rate-of-return regime to price caps for the first time and there is no experience with the proposed X-factor or assurance that it includes a consumer productivity dividend. *See Price Cap Performance Review For Local Exchange Carriers*, 12 FCC Rcd. 16,642 [¶¶ 154, 157-158] (1997).

pricing, which can be accomplished by participation in one plan or the other. No commenter has advanced a cogent reason for not requiring at least the modest step provided by the ALLTEL plan toward incentive regulation for smaller carriers. There is no plausible showing of potential harm from *allowing* smaller carriers to select the CenturyTel plan, but *requiring* them to be regulated under the ALLTEL plan if they do not. Without this minimal incentive the most inefficient small carriers could continue to operate indefinitely with little or no incentive to increase their efficiency, to the detriment of their largely captive ratepayers.

Whether mandatory or optional, two safeguards should be added to the ALLTEL plan. First, carriers who file rate increases during a relevant two-year period should be required to submit, as an integral part of their filing rather than upon request, additional tariff support to assure that such "mid-course corrections" do not undermine the cost cutting incentive that is the essence of the ALLTEL plan. Specifically, the Commission should require that any such filing include: 1) complete Part 36 and Part 69 cost support; 2) the base period historic demand for all rate elements offered in the tariff; 3) a complete set of rate development work papers including relevant access charge reform adjustments; and 4) rates of return (Form 492's) for each service category. In addition, in the event that a filing LEC shows a decline in demand but claims that its interstate investment and expenses are rising, the LEC should be required to provide a complete explanation of the need for the new investment or new expense.

Second, rate-of-return carriers filing tariffs under Section 61.39 of the Commission's Rules are now exempt from the requirement to file rate of return monitoring reports under Sections 65.700 and 65.701 of the Commission's Rules. See

Section 61.39 (c). Carriers under the ALLTEL plan should not be excused from this requirement, but rather should be required to file earnings reports so the Commission can monitor the effectiveness of the ALLTEL plan in reducing costs and see that those reduced costs are reflected in lower rates.

CONCLUSION

For the reasons stated above, the Commission should promptly adopt and implement a modified version of the CenturyTel Plan and make it mandatory at the holding company level for all rate-of-return LECs serving more than 50,000 lines. The Commission should also require those LECs (other than average schedule companies) with less than 50,000 lines at the holding company level to either elect the CenturyTel plan or operate under a modified version of the ALLTEL plan.

Respectfully submitted,

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MAG SNPRM **Attachment 1**

List of 100K and 50K Holding Companies and Study Areas

		12/03 FCC MR 2001 Loops		12/03 FCC MR 2001 Study Areas	
	50K Holding Companies and Study Areas				
1	D&E Communications, Inc.	87,209		2	
2	IL CONSOLIDATED TEL	85,703		1	
3	Lynch Interactive Corporation	52,606		14	
4	Ntelos, Inc.	51,692		2	
5	HORRY TEL COOP	97,798		1	
6	GUAM TEL. AUTH.	74,006		1	
7	VIRGIN ISLANDS TEL	69,073		1	
8	MATANUSKA TEL ASSOC	60,131		1	
9	FARMERS TEL COOP	59,905		1	
10	PIONEER TEL COOP INC	56,569		1	
		694,692	4.70% of Total ROR	25	1.98% of Total ROR
	100K Holding Companies and Study Areas				
1	Alaska Communications Systems	327,209		6	
2	ALLTEL Communications Service Corp.	2,354,679		25	
3	CenturyTel, Inc.	1,770,100		64	
4	FairPoint Communications, Inc.	243,630		28	
5	Madison River Telephone Company	192,566		4	
6	PUERTO RICO TELEPHONE	1,333,656		2	
7	Rock Hill Telephone Company	129,589		4	
8	Telephone And Data Systems, Inc.	693,162		114	
9	TXU Communications Telephone Company	169,753		2	
10	ROSEVILLE TEL CO	132,728		1	
11	CONCORD TEL CO	124,832		1	
		7,471,904	50.54% of Total ROR	251	19.92% of Total ROR
	Total 50K & 100K Holding Companies & Study Areas	8,166,596	55.23% of Total ROR	276	21.90% of Total ROR
	Total Industry ROR Carriers	14,785,359	7.97% of Total Industry	1260	87.68% of Total Industry
	Total Industry	185,588,578		1437	

Note: Frontier 2 Concurring Companies is composed of 25 study areas in 10 states that have averaged annual rate of returns of over 37% since 1996.

COMMENTING PARTIES	REFERENCE
Alltel Communications, Madison River Communications & TDS Telecom, Inc.	ALLTEL
Independent Telephone & Telecommunications Alliance	ITTA
MCI, Inc.	MCI
National Exchange Carrier Association, Inc.	NECA
National Telecommunications Cooperative Association	NTCA
Organization for the Promotion and Advancement of Small Telecommunications Companies	OPASTCO
Sprint Corporation	Sprint
United States Telecom Association	USTA
The Verizon Telephone Companies	Verizon
Wisconsin State Telecommunications Association	WSTA

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of May 2004, I caused true and correct copies of the foregoing AT&T Reply Comments to be served by electronic mail or by United States first-class mail, postage prepaid to the following parties:

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